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Public Service Commission of Wisconsin  
Rebuttal Testimony of Kevin W. O'Donnell, CFA  
Nova Energy Consultants, Inc.

Wisconsin Energy Corporation  
Docket 9400-YO-100

February 19, 2015

Public Service Commission of Wisconsin  
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1 Q. Please state your name.

2 A. My name is Kevin W. O'Donnell.

3 Q. Have you previously submitted testimony in this proceeding?

4 A. Yes, I submitted direct testimony on January 14, 2015, on behalf of the staff of the Public  
5 Service Commission of Wisconsin.

6 Q. What is the purpose of your rebuttal testimony in this proceeding?

7 A. The purpose of my rebuttal testimony is to address issues raised by John Reed and Scott  
8 Lauber in rebuttal testimony filed in this case on January 26, 2015. To be specific, I will  
9 address the following issues discussed by Mr. Reed in his rebuttal:

- 10 1. Wisconsin merger approval standards;  
11 2. Merger synergies as they related to the compilation of Mr. Reed's  
12 comparable group of utility mergers across the country;  
13 3. Financial considerations and the risk of a credit downgrade to Wisconsin  
14 utilities and corresponding ring-fencing provisions.

15 In regard to Mr. Lauber, I will address the applicant's argument in regard to  
16 responsibility for a future credit downgrade.

17 Q. How do you respond to Mr. Reed's assertion on lines 16-24 of Rebuttal-WEC-Reed-4  
18 where he likens this regulatory merger review process in Wisconsin to a feeding frenzy?

19 A. Mr. Reed has been in this business long enough to know that this Commission must allow  
20 consumers to have their voices heard in this merger review process. The Commission has

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1 the ultimate authority in this matter and will give the appropriate weight to each issue raised  
2 by the intervenors and the applicant in this case. The applicant is herein asking Wisconsin  
3 consumers to accept risks associated with the merger. It is only fair that consumers receive  
4 some benefit for the risk they are being asked to bear. Furthermore, in comparison to the  
5 \$2.4 billion acquisition premium paid to Integrys Energy and the \$47.6 million paid to  
6 Integrys Energy management in change in control payments, I believe that the Wisconsin  
7 consumer benefits suggested by the Commission staff in this case are rather modest.

8 Q. Do you believe that the concessions recommended by Commission staff in this  
9 proceeding are a “major step major step backwards for the utility industry as a whole in  
10 the state” (Rebuttal-WEC-Reed-4 lines 18-19)?

11 A. No. The Commission is charged with enacting rates and policies that are in the best  
12 interest of both ratepayers and stockholders. The concessions noted in Commission  
13 staff’s testimony are intended to help the Commission establish a fair balance between  
14 the ratepayers and the applicant.

15 **Merger Approval Standard**

16 Q. How do you respond to Mr. Reed’s assertions that the \$600 million in savings cited by  
17 Commission staff witness Kenneth Detmer is sufficient to show that the acquisition has  
18 net benefits for ratepayers?

19 A. At the time that Commission staff’s testimony was submitted on January 14, 2015,  
20 Wisconsin Public Service Corporation (WPSC) had not yet submitted its application for  
21 the Fox Unit 3 Combined-Cycle Generation Plant (Fox 3). WPSC submitted the Fox 3  
22 application on January 21, 2015, in docket 6690-CE-202. When Mr. Detmer completed  
23 his analysis, he estimated that the potential savings in future capital expenditures could be

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1           upwards of \$600 million in net present value revenue requirements over 20 years.

2           However, now that WPSC is proposing to build Fox 3, the capacity would be in excess of  
3           the combined companies' needs.

4    Q.     If the Fox 3 plant were ultimately approved by the Commission and constructed, would  
5           the estimated savings of \$600 million as cited by Commission staff witness Mr. Detmer  
6           materialize?

7    A.     No. At the present time, WEPCO is long on capacity and WPSC is short on capacity.

8           When Mr. Detmer did his analysis, it was assumed that the combined companies would  
9           essentially have WEPCO delivering capacity to WPSC at no cost. By doing so, Mr.  
10          Detmer estimated that combining the generation fleet for the two companies could result  
11          in an estimated \$600 million in avoided generation capacity charges over 20 years.

12          However, now that WPSC is proposing to build Fox 3, the capacity that would be  
13          delivered to WPSC is in excess of the combined companies' needs, thereby eliminating a  
14          significant portion of the \$600 million in savings as cited by Mr. Detmer. The net result  
15          is that Fox 3 must be delayed or a significant portion of the \$600 million plant deferral  
16          benefit as cited by Mr. Detmer in his direct testimony would not be realized.

17   Q.     Other than the filing of the Fox 3 application in docket 6690-CE-202, have there been  
18           any new developments in the acquisition process since the time of your pre-filed direct  
19           testimony?

20   A.     Yes. Since the filing of my pre-filed direct testimony, WEC has announced plans to sell  
21           its Michigan electric distribution assets as well as its Presque Isle Power Plant to Upper  
22           Peninsula Power Company. This sale is, reportedly, due to a settlement reached between  
23           WEC and the state of Michigan in relation to the acquisition of Integrys Energy by WEC.

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1 Q. Why is the sale of the WEC assets in Michigan important to Wisconsin state regulators?

2 A. At this point in time, we do not know the true effect that the sale of the Michigan assets  
3 will have on Wisconsin ratepayers. There are many issues, such as deferred taxes, cost  
4 allocations, etc. that must be examined prior to the sale being completed. In addition, to  
5 the extent that WEC sold its Michigan assets at a value less than current market value, the  
6 Wisconsin Commission may want to consider that discount in relation to the favored  
7 nations clause I have suggested in my direct testimony.

8 **Merger Synergies**

9 Q. How do you respond to Mr. Reed's statement on Rebuttal-WEC-Reed-8 lines 18-19 that  
10 it is not unprecedented for a utility to enter into a \$9.1 billion transaction without a  
11 detailed financial analysis?

12 A. As I stated in my direct testimony, I believe that basic fiduciary duty mandates that WEC  
13 and Integrys Energy provide its board of directors some analysis of how the merger will  
14 benefit its stockholders.

15 [REDACTED]  
16 [REDACTED]  
17 [REDACTED]  
18 [REDACTED]  
19 [REDACTED]  
20 [REDACTED]  
21 [REDACTED]  
22 [REDACTED]

23 Q. Did you review the 27 mergers cited by Mr. Reed in his testimony?

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1    A.    Yes, I did.

2    Q.    How many of those 27 merger cases involved consumers of the merging utility receiving  
3           some sort of monetary compensation such as rate credits, rate freezes, or operating  
4           expense/rate base offsets?

5    A.    In 22 of the 27 cases cited by Mr. Reed, consumers in at least one of the jurisdictions of the  
6           utilities cited in the merger received some form of compensation in the final disposition of  
7           the merger review process. Unfortunately, Mr. Reed's analysis in this merger focuses solely  
8           on the front-end of the application process and not the end result of the regulatory process.  
9           As such, Mr. Reed's presentation in his direct and rebuttal testimonies is akin to the pre-  
10          game show of an athletic event. By citing only what the utilities presented to the regulators  
11          in the application process, Mr. Reed has not presented any evidence to the Commission as to  
12          how state regulators in other jurisdictions handled similar acquisition cases. Such a  
13          presentation is utterly meaningless to state regulators that must make informed decisions  
14          based on fairness and balance involving all parties to this merger process.

15   Q.    Do you believe it is proper to exclude merger cases that were terminated?

16   A.    No. Mr. Reed excluded merger cases where the merger was terminated (Rebuttal-WEC-  
17          Reed-10, line 4), but he did not provide any reason for this action. By omitting those  
18          cases, Mr. Reed improperly narrowed his list of merger reviews. I included merger cases  
19          that were terminated because I felt it was important to give the Commission as much  
20          information as possible for them to make an informed judgment on the merits of this  
21          application.

22   Q.    Did you attempt to limit the scale of your merger reviews as did Mr. Reed (Rebuttal-  
23          WEC-Reed-10, line 6)?

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1 A. No. I did not limit my scale at all. Small utilities have just as much merger synergy  
2 potential, at least on a percentage basis, as do large utilities. I see no reason at all to limit  
3 the review based on size.

4 Q. What was the size limit that Mr. Reed applied in his comparable merger case group?

5 A. Mr. Reed does not provide that information in his rebuttal testimony. On Rebuttal-WEC-  
6 Reed-10 line 6, he does say that he limited the review to acquisitions of only a “significant  
7 scale.” However, Mr. Reed does not state what that limit was in his analysis. In addition, I  
8 find such a statement in conflict with the fact that one of his mergers, the Integrys  
9 Energy/Alliant transaction in Minnesota in 2013, involved the sale of \$128 million in  
10 electric and gas distribution assets. This acquisition is a relatively small transaction  
11 compared to the current WEC acquisition of Integrys Energy, yet, Mr. Reed found it  
12 appropriate to include this merger in his analysis. It is not clear, then, what criteria Mr.  
13 Reed is actually using to pick and choose which mergers he include in his analysis.

14 Q. Do you agree with Mr. Reed’s statement that you did not provide a comparison of merger  
15 standards for other states?

16 A. No. Mr. Reed has misrepresented my testimony in this regard. Section II of my direct  
17 testimony (see Direct-PSC-O’Donnell-14 and 15) provides a detailed review of merger  
18 standards across the country.

19 Q. Did Mr. Reed misrepresent any other part of your testimony in regard to merger review  
20 standards in Wisconsin?

21 A. Yes. On Rebuttal-WEC-Reed-11 lines 6-9 Mr. Reed states that my review of the  
22 Wisconsin merger standard requires the Commission to offer bill credits, rate freezes, and  
23 write-offs. This is incorrect.

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1           What I offered in my testimony was a review of how other state regulators  
2 managed utility merger cases. From this analysis, I then offered the Commission options  
3 that it can pursue if it believes consumers in Wisconsin should receive specific and  
4 quantifiable benefits as a result of this transaction.

5   Q.   How do you respond to Mr. Reed's statement on Rebuttal-WEC-Reed-13 line 2 that an  
6 upfront credit to Wisconsin consumers is unreasonable?

7   A.   Apparently many other state regulators would disagree with Mr. Reed in this matter as in  
8 45 of the 67 cases that I reviewed and were approved, state regulators approved some  
9 form of upfront monetary benefit to consumers.

10           The primary difference between Mr. Reed's position and my suggestion of an  
11 upfront monetary benefit for consumers is which party, the applicant or its ratepayers,  
12 should absorb the risk that the applicant ultimately fails to produce the estimated savings.  
13 Mr. Reed wants to put that risk entirely on Wisconsin ratepayers, which have no  
14 operational control in the process. If, on the other hand, the applicant bears that risk, it  
15 will have a very strong incentive to make the merger process work so that it can achieve  
16 the estimated savings and recover the upfront rate credit allocated to consumers.

17   Q.   How do you respond to Mr. Reed's assertion that you misstated his representation of  
18 AMAX Magnesium Corporation in the merger between Utah Power and Light and what  
19 is now PacifiCorp in 1987?

20   A.   In that case, Mr. Reed was apparently unhappy that his client was not receiving the  
21 2 percent rate cut that other consumers in Utah were also receiving. Such a statement is  
22 in stark contrast to the current proceeding where Mr. Reed does not believe consumers  
23 should get any allocated savings upfront, but instead should wait to see how the merger

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1 process unfolds. Contrary to the statements in his rebuttal testimony, Mr. Reed's  
2 testimony in this case contradicts the position he took in 1987 and undermines his  
3 position in the current proceeding.

4 Q. Do you agree with Mr. Reed that an upfront monetary savings for consumers is  
5 "pre-deciding future rate proceedings" (Rebuttal-WEC-Reed-16, lines 16-17)?

6 A. No. As stated above, the issue boils down to risk. Mr. Reed wants to place all the risk of  
7 merger savings on Wisconsin consumers. In contrast, a Commission directive for some  
8 form of upfront savings to ratepayers puts the risk of deriving merger savings on the  
9 applicant, which is the only entity involved in this matter that has control over the  
10 post-acquisition integration process.

11 In addition to the matter of risk, denying ratepayers an upfront rate credit also  
12 creates an incentive for the applicant not to minimize costs in the merger integration  
13 process. If ratepayers have to wait for merger savings, the Companies have no incentive  
14 to minimize transition costs and maximize synergy savings. However, if the applicant  
15 knows that it must recover a set amount of savings allocated to consumers, it is more  
16 likely to be much more diligent in the manner in which they incur integration costs.

17 Mr. Reed himself provides evidence to support my concern about the disincentive  
18 to minimize the transition costs when he argues on Rebuttal-WEC-Reed-20 lines 3-10  
19 that the Commission should not limit transition costs. Mr. Reed's position in this case is  
20 that the Commission should trust the applicant to produce savings but, at the same time,  
21 the Commission should not limit what the applicant spends on transition costs.



**Financial Considerations**

Q. Has the applicant provided any evidence that this merger will lower financing costs for the combined companies?

A. No, contrary to the statements of Mr. Reed, the applicant has offered no assurances at all that financing costs will be lowered due to this merger. In fact, there is a risk that financing costs could increase if the debt of WEC Energy is downgraded after the completion of the merger.

Q. Do you agree with Mr. Reed that a change in the ratings outlook is not an indication that the credit rating is expected to change?

A. I agree that a change in the outlook does not guarantee that the credit ratings will change in the future. However, a change in the outlook does indicate that there is a risk that the credit rating will change in the future. Such is the case with the acquisition of Integrys Energy by WEC. By taking on \$1.5 billion in debt to finance the acquisition, WEC, its regulated utility subsidiaries, and its ratepayers are at risk of paying higher interest costs in the future. The stockholders of Integrys Energy are being compensated for assuming this risk by WEC paying them a \$2.4 billion acquisition premium for their shares of stock. WEC stockholders have seen the value of their stock holdings increase by roughly 31 percent in 2014. Consumers, on the other hand, have not received anything to compensate them for the higher risk assumed in this merger nor does the applicant want consumers to be allocated anything in this merger review process.

Q. Has the applicant indicated a willingness to absorb the risk of a credit downgrade should that occur as a result of WEC incurring such a large amount of debt to finance the acquisition of Integrys Energy?

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1     A.     WEC has stated that it will not absolve ratepayers of higher interest costs should the  
2           utility subsidiary credit ratings be downgraded. As a result, the applicant is asking  
3           consumers to bear this risk without compensation for the additional risk.

4     Q.     How do you respond to Mr. Reed’s criticism of your testimony that you do not provide a  
5           basis for your discussion on WEC’s return on equity achieved over the past 13 years?

6     A.     I am afraid that Mr. Reed did not thoroughly read my testimony. Had he done so, he  
7           would have seen that I directly answered that question at Direct-PSC-O’Donnell-14.

8     Q.     Do you agree with Mr. Reed that reviewing past earnings is tantamount to “retroactive  
9           ratemaking” (Rebuttal-WEC-Reed-41, line 5)?

10    A.     Not at all. As stated above, it is important for the Commission to review WEPCO’s past  
11          earnings to assess the health of the company and its ability to offer consumers any  
12          upfront compensation. WEPCO has a history of strong earnings in Wisconsin. Contrary  
13          to Mr. Reed’s statements, nothing in this Commission’s staff recommendation involves  
14          recovery of WEPCO past earnings. Such a statement is just patently false.

15               Commission staff’s point in this matter is quite simple. We believe it is  
16          appropriate for the Commission to take the history of strong WEPCO earnings into  
17          consideration in determining whether or not the applicant should be required to offer  
18          consumers some monetary compensation upfront in this case.

19    Q.     How do you respond to Mr. Lauber’s statement that the applicant cannot agree to  
20          compensate ratepayers for higher financing costs that may result from the merger?

21    A.     The applicant asked for this merger. In so doing, the applicant has imposed risks on its  
22          customers. One very real risk in this acquisition is that future financing costs for the  
23          utility subsidiaries may very well increase. The credit rating of WEC has been put on

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1 watch due to the large amount of debt it is taking on in order to finance this merger. In  
2 my direct testimony, I provided evidence to show that utility subsidiary ratings are linked  
3 to the credit rating of the utility parent companies. If, due to this acquisition, the credit  
4 rating of the utility subsidiaries falls, the cost of financing will increase to consumers.

5 Mr. Lauber refuses to accept responsibility for any downgrade possibilities. He  
6 claims that "...it would be nearly impossible to disentangle the factors contributing to  
7 such a hypothetical downgrade...." The credit ratings for WEC and its subsidiaries are  
8 being discussed in this proceeding due to the simple fact that WEC has chosen to finance  
9 part of this acquisition through the issuance of a large amount of debt. Instead of issuing  
10 debt, the applicant could have chosen to pay a lower price for Integrys Energy or it could  
11 have issued more common equity. It chose debt and, in doing so, created a chance of a  
12 credit downgrade for WEC and its utility subsidiaries. WEC, and not the ratepayers,  
13 should bear the entire risk of higher financing costs associated with this acquisition. In  
14 other words, Wisconsin ratepayers should not bear the burden to prove the cause of any  
15 subsequent credit downgrade.

16 Q. Do you have any concluding comments?

17 A. Yes. My silence on any comments should not be construed as agreement with any  
18 particular position taken by any witness.

19 Q. Does this complete your rebuttal testimony?

20 A. Yes, it does.

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